Securities Industry Trends

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AN ANALYSIS OF EMERGING TRENDS IN THE SECURITIES INDUSTRY
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The 1984 Performance of the Securities Industry

Highlights

1. Industry after-tax ROE dropped to 7.2% in 1984, the lowest level since 1977. The ten firms categorized as Large Investment Banks (LIBs) received 72% of the industry's pre-tax income. Excluding the LIBs, the industry's after-tax ROE was a disappointing 2.9%, after averaging nearly 21% from 1979-1983.

2. Commissions fell 15% to $7.1 billion in 1984 and accounted for only 23% of total revenues, the lowest percentage recorded since such data were tabulated by the regulatory organizations.

3. Trading profits increased 11% in 1984 to a record $7.5 billion and were, for the first time, the largest revenue source on an annual basis.

4. Underwriting revenues dropped 24% in 1984 to $2.7 billion largely because of a 67% plunge in revenues from underwriting equity securities.

5. Employment expenses declined 3% in 1984 because management exercised controls to limit both employment and salary increases while RR compensation fell due to the drop in RR production.

6. Concentration in total revenues and capital increased for the Top 10 firms as two of the larger firms in the Top 11-25 firms in 1983 were acquired in 1984 by firms in the Top 10.

Securities Industry Association
120 Broadway • New York, N.Y. 10271 • (212) 608-1500

Introduction

This issue of Trends analyzes the securities industry's 1984 performance in the aggregate including the economic environment, profitability, revenues, expenses and concentration. Profitability and other trends in 1984 by firm category will be examined in a forthcoming Trends issue.

1984 Economic Environment

The profitability of the securities industry is usually closely correlated with the current and future economic environment . However, this was not the case last year. In 1984, the overall performance of the economy was very strong. Real GNP rose 6.8%, the largest gain since 1951, prices increased only 3.8% and civilian employment expanded by 4.2 million. However, monetary authorities were still concerned about a resurgence of inflation because of a fiscal policy considered expansionary. Whenever economic growth accelerated, monetary policy was tightened to prevent a resurgence of inflation. As a result, there was volatility in the economy's performance on a quarterly basis. In addition, there was uncertainty about future economic trends which affected the securities markets unfavorably. High interest rates and uncertainty emanating from the conflict between monetary and fiscal policies affected securities prices and industry profitability adversely.

First Quarter

During the first quarter, it was difficult to guage the pace of economic growth. Strong growth was reflected in residential and nonresidential investment and consumer durables but some key preliminary indicators such as retail sales and GNP initially pointed to only a moderate increase. Later, significant upward revisions were made to these indicators. Real GNP growth was finally reported as climbing an impressive 10.1%.

Interest rates declined until mid-February but then rose during the rest of the quarter because of rapid growth in the monetary and credit aggregates and Treasury borrowings of $47 billion. Market participants remained pessimistic about the outlook for interest rates and feared a conflict between government and private credit demands given the size of the deficit. The Federal funds rate rose from 9.0% to 9.6%, and the 30-year government bond rate went from 11.8% to 12.5%. The pessimistic interest rate outlook hurt the stock market and the Dow Jones Industrial Average fell from 1259 to 1165.

Second Quarter

Economic expansion continued at a fairly rapid pace as real GNP rose by 7.1%. Most sectors contributed to this increase including consumers, nonresidential and residential investment, business inventories and government spending. However, agricultural and oil related industries as well as export related industries did poorly. The strong U.S. dollar caused the trade deficit to remain at a record level. Civilian employment rose by nearly 1.3 million; the unemployment rate dropped to 7.2%; and inflation declined to 3.3%.

Interest rates continued to rise. The Federal Reserve tightened monetary policy in light of the significant increase in economic growth. The discount rate was raised from 8.5% to 9.0%. Continental Illinois National Bank and Trust Company of Chicago was not able to fund itself in May and had to rely on the Federal Reserve's discount window for funds. The Federal Reserve drained reserves in other ways to offset reserves lent to Continental Illinois. Banks began to hoard reserves to protect themselves. Also contributing to higher interest rates was the Treasury's borrowings of $30 billion and continued fear of a collision over financing needs between the public and private sectors. The Federal funds rate jumped above 11% and the rate on 30-year Government bonds climbed to nearly 14%. As a result, stock prices continued to decline with the Dow Jones Industrial Average falling to 1132 by the end of the second quarter.

Third Quarter

Economic growth slowed in the third quarter largely because of the substantial rise in interest rates which had occurred during the previous two quarters. Long-term rates peaked at the end of the second quarter. Consumer expenditures were flat, housing expenditures declined but nonresidential investment continued to increase. The trade deficit grew larger as imports climbed faster than exports and business inventories rose. Consequently, annual growth in real GNP slowed to 1.6%.

Short-term interest rates rose through mid-August because the Federal Reserve continued a restrictive monetary policy. The Federal funds rate peaked at 11.8% in mid-August. Also, there were debt restructuring negotiations with several countries and financial strains in certain sectors of the U.S. economy such as agriculture and oil drilling. Federal assistance was also required for Financial Corporation of America. Bankers maintained higher reserves as a precaution against a liquidity crisis. Thereafter, monetary policy became more accommodating. By the end of the third quarter, the Federal funds rate declined to 10.7%.

The yield curve became flatter as long-term interest rates began declining at the beginning of the third quarter. This occurred despite the $52 billion of new debt issued by the Treasury. Foreign demand for U.S. government securities increased with the removal of the 30% withholding tax on foreign interest receipts from U.S. debt securities. At the end of the third quarter, the rate on 30-year government bonds fell to 12.3%. Stock prices rose in response to the mid-August easing of monetary policy and the Dow Jones Industrial Average ended the third quarter at 1207.

Fourth Quarter

Economic growth increased in the fourth quarter largely due to a significant reduction in the trade deficit. Consumer outlays rose as did government expenditures, but nonresidential investment eased while housing again declined. The rise in business inventories moderated. Inflation fell as prices rose less than 3%. Real GNP increased 4.3% in the fourth quarter.

Interest rates fell throughout the fourth quarter as the Federal Reserve continued a more accommodative policy because of concern over economic activity stalling, sluggish growth in M1 and a favorable inflation outlook. The discount rate was lowered to 8.5% in November and 8.0% in December. Rates dropped despite the Treasury issuing $60 billion of debt. By year-end, the Federal funds rate fell to less than 8.0% while the 30-year government bond rate was 11.5%. Nevertheless, stock prices did not appreciably rise as the Dow Jones Industrial Average ended the year at 1212.

Industry Profitability

Profitability plunged in 1984 because of rising interest rates and investors' fears over a clash between monetary and fiscal policies. The after-tax return-on-equity (ROE) in 1984 dropped to 7.2%, its lowest level since 1977 (Table 1). In comparison, the average after-tax ROE for all kinds of manufacturing was 12.8% in 1984. However, 1984 was even more disappointing for most firms then is indicated by the industry's ROE as a very high proportion of pre-tax income was earned by a relatively small number of firms. The ten firms categorized as Large Investment Banks (LIBs) received 72% of the industry's pre-tax income and enjoyed an after-tax ROE of 16.8%. Excluding the LIBs, the industry's after-tax ROE was a dismal 2.9%. Just as discouraging, 35% of all NYSE firms doing a public business were unprofitable in 1984.

Table 1

Securities Industry After-Tax ROE

Annual After-Tax ROE		Standard Deviation of Quarterly After-Tax ROE		1984 Quarterly After-Tax ROE	
1977	6.9%	1977	2.3	I	9%
1978	11.2	1978	12.6	II	(2)
1979	15.6	1979	2.4	III	12
1980	26.6	1980	9.0	IV	9
1981	19.4	1981	7.2		
1982	22.0	1982	14.6		
1983	19.8	1983	10.6		
1984	7.2	1984	6.2		

( ) Negative

Pre-tax income dropped 58% in 1984 from 1983. Revenue growth slowed to 6% while expenses rose 15%, largely because of higher interest expense. Indeed, the climb in interest expense accounted for 89% of the rise in costs. Proximate non-interest revenues decreased 4% while non-interest expenses increased 2%.[1/] As a result, the industry's pre-tax profit margin dropped sharply (Table 2).[2/] The ROE was also adversely affected by a decline in asset turnover, a rough "productivity" measure of assets. The leverage ratio, which measures the degree debt is relied upon to support the asset base compared to equity, rose to over 19%.

1/Proximate non-interest revenues consist of total revenues less margin interest revenue and other-related revenue.

2/Profit margin (pre-tax earnings per dollar of revenue) times asset turnover (revenues per dollar of average assets) times leverage (average assets per dollar of average equity) times the tax retention rate (1 minus industry tax rate) equals after-tax earnings per dollar of average equity (ROE).

Table 2

Component Analysis of Industry After-Tax Return on Equity

	Profit Margin	x	Asset Turnover	x	Leverage	x	Tax Retention Rate	=	ROE
1982	.1308%		.1787		17.3%		54.0%		21.9%
1983	.1294		.1631		17.3		54.0		19.8
1984	.0515		.1348		19.1		54.0		7.2

On a quarterly basis, pre-tax profits ranged from a high of almost $700 million during the third-quarter of 1984 to a loss of $98 million in the second-quarter, the first quarterly loss since the fourth-quarter of 1978. Annualized after-tax ROE was comparatively low for each of the quarters. Also, the volatility of 1984 quarterly profits was the lowest since 1979 as is indicated by comparing the respective standard deviations (Table 1). In recent years, there has been a positive relationship between volatility in quarterly profits and ROE. In 1984, the volatility in quarterly profits and annual ROE were both relatively low.

Revenues

Total revenues rose from $29.5 billion in 1983 to $31.2 billion in 1984. Two important revenue sources, commissions and underwriting, both actually fell last year (Table 3). However, trading profits, margin interest and other related-revenues to the securities business increased.

Table 3

Securities Industry Revenues, 1983 and 1984

(millions of dollars)

REVENUES[1/]	1983 Dollars	1983 % of Total	1984 Dollars	1984 % of Total
Commissions				
Listed Equities on an Exchange	$6,129.7	20.7%	$5,232.6	16.8%
Listed Equities Executed OTC	112.3	0.4	75.0	0.2
Listed Options	796.6	2.7	822.3	2.6
Other	1,304.1	4.4	964.7	3.1
Total	8,342.9	28.2	7,094.6	22.7
Trading Profits				
Market Making OTC	1,380.9	4.7	862.9	2.8
Debt Securities	4,417.8	15.0	5,524.9	17.7
Options on Nat'l Exchange	63.6	0.2	31.1	0.1
Other	981.3	3.3	1,147.7	3.7
Total	6,838.8	23.1	7,563.8	24.2
Investment Profits				
Realized	495.7	1.7	697.7	2.2
Unrealized	178.0	0.6	(10.4)	(0.0)
Total	742.9	2.5	713.8	2.3
Underwriting				
Equity Securities	754.2	2.6	248.3	0.8
Total	3,536.7	12.0	2,706.1	8.7
Margin Interest	2,125.5	7.2	2,867.8	9.2
Mutual Fund Sales	952.0	3.2	750.9	2.4
Account Supervision	569.6	1.9	693.8	2.2
Research	18.7	0.1	11.1	0.0
Commodities	826.1	2.8	739.3	2.4
Other-Related	4,384.1	14.8	6,282.8	20.1
Other-Unrelated	1,207.6	4.1	1,792.1	5.7
TOTAL REVENUES	$29,544.9	100.0%	$31,216.0	100.0%
TOTAL EXPENSES	$25,721.6		$29,608.2	
PRE-TAX NET INCOME	$3,823.3		$1,607.8	

( ) Negative

1/Discrepancies may exist due to rounding.

Source: Securities Industry Database

Commissions

Commissions fell 15% in 1984, the most significant drop since 1974 when a similar decrease occurred (Table 4). In addition, commissions accounted for only 23% percent of total revenues, the lowest percentage recorded since such data were first tabulated by the regulatory organizations. For the first time, commissions were not the largest annual revenue source as they were overshadowed by trading profits.

Table 4

Commission Revenues

(millions of dollars)

Commissions	1983	1984	% Change
Listed Equities on Exchanges	$6,129.7	$5,232.6	(14.6)%
Listed Equities Executed OTC	112.3	75.0	(33.2)
Listed Options	796.6	822.3	3.2
Other	1,304.1	964.7	(26.0)
Total	$8,342.9	$7,094.6	(15.0)%

The amount of commissions received by the industry is based upon volume (activity) and the average commission per share of stock traded (price). Commission charges, in turn, are impacted by the mix of retail and institutional activity, changes in commission rates and the average price per share of stock traded. In 1984, total share volume on stock exchanges less member trading increased less than 2%; however, the average commission per share of stock traded dropped in 1984 which caused total commissions to fall (Table 5).3/

3/Total share volume including purchases and sales less member trading on the NYSE, AMEX and regional exchanges is estimated to have risen from 43.1 billion shares in 1983 to 43.8 billion shares in 1984, or by 1.6%. Firms generally obtain mark-ups from customer transactions in NASDAQ stocks rather than commissions. Consequently, these mark-ups are reported in trading profits and not in commissions.

Table 5

Equity Sales Volume, Price and Value[1/]

1984

Registered Stock Exchanges	Average Daily Share Volume (In Millions)	Annual Share Volume (In Millions)	Price/Share Traded	Dollar Value of Shares Traded (In Millions)
NYSE	91.2	23,071	$33.15	$764,737
AMEX	6.1	1,545	13.82	21,349[2/]
Regional Exchanges	14.1	3,571	33.70	120,359
	111.4	28,187	$32.16	$906,445

1983

Registered Stock Exchanges	Average Daily Share Volume (In Millions)	Annual Share Volume (In Millions)	Price/Share Traded	Dollar Value of Shares Traded (In Millions)
NYSE	85.3	21,590	$33.45	$765,275
AMEX	8.2	2,081	15.14	31,501[2/]
Regional Exchanges	13.3	3,368	31.67	106,653
	106.9	27,039	$33.41	$903,429

1/Round-lot data.

2/AMEX dollar value of shares traded includes odd-lot.

Sources: NYSE, AMEX and NASDAQ Fact Book, 1983 and 1984.

The decline in retail activity was a major reason for the fall in the average commission per share of stock traded. The estimated proportion of total commissions from retail business dropped from 40% in 1983 to 35% in 1984 (Table 6), explaining a significant proportion of the drop in the average commission per share.[4/] Moreover, institutional commission rates declined in 1984 due to intense competition.

Table 6

Estimated Percentage of Retail & Institutional Commissions, 1983-1984

	Estimated Retail Commissions		Estimated Institutional Commissions	
Quarter	1983	1984	1983	1984
I	45.2%	34.5%	54.8%	65.5%
II	43.1	34.4	56.9	65.6
III	37.5	33.8	62.5	66.2
IV	34.4	36.7	65.6	63.3
Year	40.0%	34.8%	60.0%	65.2%

4/ The most recent year for which the SEC conducted a survey to determine retail versus institutional commissions was in 1981 when retail commissions were 65% and institutional commissions were 35% of total commissions. The retail percentage of total commissions is estimated for later periods by using the following ratio:

$$\frac{.65}{X} : \frac{(1-[10{,}000 \text{ share blocks \& member trading as \% NYSE volume, 1981}])}{(1-[10{,}000 \text{ share blocks \& member trading as \% NYSE volume, period X}])}$$

The institutional percentage of total commissions is the residual.

For example, the ratio to estimate the percentage of retail commissions for 1983 is:

$$\frac{.65}{X} : \frac{(1-[.318 + .266])}{(1-[.456 + .288])} \quad \text{or} \quad \frac{.65}{X} : \frac{.416}{.256}$$

Trading Profits

Trading profits were one of the few major revenue sources to increase last year, rising to a record $7.5 billion from $6.8 billion reached in 1983, a 10.6% increase (Table 7). In addition, they were the largest revenue source on an annual basis for the first time ever. Nearly 60% of 1984's trading profits occurred in the third and fourth quarters when interest rates were declining.

Table 7

Trading Profits

(millions of dollars)

	1983	1984	% Change
OTC Market Making	$1,380.9	$ 862.9	(37.5)%
Debt Securities	4,417.8	5,524.9	25.1
Options on Nat'l Exch.	63.6	31.1	(51.1)
Other	981.3	1,147.7	17.0
	$6,838.8	$7,563.8	10.6%

( ) Negative

Among the components, trading profits on debt securities climbed 25% from 1983 and accounted for 73% of total trading profits. However, OTC market making plunged about 38% as OTC equity prices fell in the second and fourth quarters.

Underwriting

Underwriting revenues fell almost 24% in 1984, the sharpest decrease among the largest revenue sources (Table 8). Clearly, 1984 was a disappointing year for underwriting, but last year's performance suffers from a comparison with 1983. In 1983, underwriting revenues jumped 52% from 1982 to a record $3.5 billion. Thus, 1984 underwriting revenues, although down from 1983, were still 17% higher than in 1982 and significantly greater than in any other year except 1983. The 1984 drop in underwriting revenues occurred largely because of the 67% plunge in revenues from underwriting equity securities. Revenues from underwriting debt securities decreased by 12%.

Table 8

Underwriting Revenues

(millions of dollars)

	1983	1984	% change
Equity Securities	$754.2	$248.3	(67.1)%
Non-equity Securities	2,782.5	2,457.8	(11.7)
Total	$3,536.7	$2,706.1	(23.5)%

Corporate underwriting volume on a net proceeds basis fell to $82.2 billion in 1984 compared with the record $97.1 billion in 1983 (Table 9). However, debt financing rose to a record $69.3 billion from $52.2 billion. Common stock offerings plunged to $8.9 billion in 1984 after reaching a record $36.7 billion the previous year. Also, IPOs fell to $3.8 billion in 1984 compared with the record $12.4 billion in 1983.

Table 9

Underwriting Volume

(billions of dollars)

	1983		1984		% change	
	Dollars	No. of Issues	Dollars	No. of Issues	Dollars	No. of Issues
I. Corporate						
Bonds	$52.2	605	$69.3	648	32.8%	7.1%
Preferreds	8.3	131	3.9	70	(53.0)	(46.6)
Common	36.7	1,418	8.9	557	(75.7)	(60.7)
IPOs	12.4	686	3.8	351	(69.4)	(48.8)
	$97.1	2,154	$82.2	1,275	(15.3)%	(40.8)%
II. Municipal						
Rev. Bonds	$60.8	NA	$74.4	NA	22.4%	NA
GOs	22.6	NA	27.5	NA	21.7	NA
	$83.4	NA	$101.9	NA	22.2%	NA

( )Negative

NA Not Available

Sources: Dealers' Digest Inc. and The Bond Buyer

Negotiated Rule 415 total offerings on a net proceeds basis rose 10%, from $36.0 billion in 1983 to $39.7 billion in 1984. Rule 415 debt offerings climbed 42%, from $27.1 billion in 1983 to $38.5 million in 1984.[5/] Such offerings represented 52% of corporate debt offerings in 1983 and nearly 56% in 1984. However, Rule 415 equity offerings plunged 86%, from $8.9 billion in 1983 to $1.2 billion in 1984.[6/] As a percentage of total equity offerings, 415 offerings accounted for 20% in 1983 but less than 10% in 1984.

Municipal volume set a record of $101.9 billion in 1984, 22% greater than in 1983. In 1984, revenue bonds accounted for 73% of total municipal volume. Activity was limited in the first-half of 1984 because single-family mortgage revenue bonds could not be issued since they were sunsetted as of December 31, 1983. Moreover, there was uncertainty regarding the amount of industrial development bonds (IDBs) which could be sold. After enactment of the Deficit Reduction Act of 1984 in mid-year, volume climbed dramatically. The Act again permitted the sale of single-family mortgage revenue bonds and stipulated the annual limit on IDBs beginning January 1, 1985. Activity in IDBs soared during the fourth-quarter of 1984 prior to the effective date of the ceiling. Overall, more than 64% of 1984 volume was accounted for during the second-half of the year.

Concentration in underwriting revenues increased in 1984 for the Top 10 and particularly the Top 11-25 firms (Table 10). This occurred largely because of the drop in equity offerings, particularly IPOs, where smaller firms play a larger role in underwriting and distributing securities. In addition, the climb in Rule 415 shelf offerings increased concentration because such transactions are generally handled by larger capitalized firms.

Table 10

Concentration in Underwriting Revenues

Firm Rankings[1/]	1980	1981	1982	1983	1984
Top 10	53.1%	50.4%	57.8%	46.2%	47.8%
Top 11-25	22.6	23.3	22.8	29.9	33.9
Top 25	75.6	73.7	80.5	76.1	81.7
Rest of Industry	24.3	26.3	19.5	24.0	18.3
	100.0%	100.0%	100.0%	100.0%	100.0%

1/Firm rankings are by capital.

5/ Dealers' Digest Inc.

6/Ibid.

The Top 11-25 firms' increased concentration in underwriting revenues in 1984 is somewhat surprising considering that two of the largest firms in this group were acquired during the year by Top 10 firms.[7/] Also unexpected was the relatively small rise in concentration for the Top 10 firms. However, these changes seem to have occurred because of differences in the types of underwriting activities in 1984 compared with 1983. The Top 10 firms' comparatively small increase in concentration in 1984 appears to have resulted because of lower profit margins due to the increased importance of debt underwriting as well as larger deals. Profit margins on debt underwritings are smaller compared with equity underwritings and are lower, on average, as the size of the underwriting increases. The Top 11-25 firms' increase in concentration is explained by their role in the municipal business which rose significantly last year.

Margin Interest

Margin interest revenue climbed 35% in 1984 after increasing 6% in 1983. However, net margin interest income, not gross margin interest revenue, is the important variable for profitability. The trend in net margin interest is suggested by available data including NYSE customer margin debit balances, free credit balances, the broker call rate and the estimated rate charged margin customers (Table 11). Other data not available but useful in determining the profitability of margin business are cash debits against which free credits are used and revenues received by firms on stocks loaned on customer margin accounts. Available data indicate that net margin interest revenue rose in 1984 as customer margin debit balances climbed 27% and free credit balances increased 4%.

Table 11

Indicators of Net Margin Interest Income[1/]

(billions of dollars)

	NYSE Customer Margin Debit Balances	Free Credit Balances	Average Broker Call Rate	Estimated Rate Charged Margin Customer
1981	$14.2	$ 9.0	17.85%	19.35%
1982	12.0	11.7	13.43	14.90
1983	17.8	14.4	10.09	11.44
1984	22.6	15.0	11.23	12.72

1/All data are averages.

Sources: NYSE, Data Resources, Inc. and Lipper Analytical

7/In 1984, Merrill Lynch acquired portions of A.G. Becker Paribas and Shearson/American Express acquired Lehman Brothers.

Other-Related

Other-related revenues to the securities business basically include interest on repos, M&A fees, private placement fees and interest earned on investments. In 1984, other-related revenues climbed 43% after increasing 12% in 1983. Interest on repos is believed to be the largest component of this revenue item. The overnight average repo rate increased from 9.1% to 10.1%, while the average amount of reverse repos climbed 52%, from $57.1 billion in 1983 to $86.9 billion in 1984.

M&A fees and private placement fees also contributed to the climb in other-related revenues. As reported by W.T.Grimm, M&A activity jumped to a record $122.2 billion in 1984, up from $73.1 billion in 1983. The previous high was $82.6 billion set in 1981. Factors contributing to this new peak in M&A activity were companies perceived as undervalued, structural changes in industries such as oil, computer software and broadcasting, as well as strategic takeovers.

A new record also occurred in private placements which rose in 1984 to $53.1 billion and included 1,781 issues compared with $35.6 billion and 1,597 issues in 1983. The private placement market is one of the fastest growing parts of the securities business. Annual volume last year was 119% greater than in 1982 and the growth in collateralized mortgage obligations (CMOs) has been the major contributing factor.

Growth in total revenues in 1984 was the smallest since 1977. Also, the trends which have existed since at least 1973--the growing importance of principal business and the diminishing importance of agency business--continued last year. Senior securities industry executives surveyed in the SIA/Arthur Andersen Delphi Study predicted that the trend of rising importance for trading and investment profits and the reduced importance of commissions would continue in the late 1980s.[8/]

8/SIA and Arthur Andersen & Co., Keys to a Changing Securities World, 1985, p.30-32

EXPENSES

As industry profits fell and many firms experienced losses, policies were adopted in 1984 to constrain overall costs although spending continued where prior commitments had to be met and in areas necessary to remain competitive. Total expenses climbed 15% compared with revenues increasing only 6% (Table 12). However, non-interest expenses rose only 2% while proximate non-interest revenues decreased 4%.

Table 12

Securities Industry Expenses

(millions of dollars)

EXPENSES[1]	1983 Dollars	1983 % of Total Revenues	1984 Dollars	1984 % of Total Revenues
Registered Rep. Comp.	$5,748.3	19.5%	$5,248.5	16.8%
Clerical & Admin.	4,887.6	16.5	5,147.5	16.5
Partners' & Stock.	983.1	3.3	934.1	3.0
Other Employee Comp.	448.5	1.5	396.7	1.3
Floor Brokerage & Clearance	1,142.2	3.9	1,162.6	3.7
Fl. Brok.-Brokers	389.9	1.3	399.1	1.3
Comm. & Clear.-Others	390.2	1.3	395.3	1.3
Clear. Pd. Non-Brokers	246.4	0.8	257.9	0.8
Comm. Pd.-Other Brokers	115.8	0.4	110.7	0.4
Communications	1,536.7	5.2	1,766.4	5.7
Occupancy & Equipment	1,137.1	3.8	1,503.7	4.8
Promotional Costs	734.4	2.5	769.2	2.5
Interest	6,050.6	20.5	9,505.4	30.5
Error Accts. & Bad Debts	232.6	0.8	212.0	0.7
EDP Equipment Costs	342.2	1.2	419.8	1.3
Non-recurring Charges	98.5	0.3	26.2	0.1
Regulatory Fees & Exp.	133.7	0.5	144.9	0.5
Other	2,249.0	7.6	2,372.3	7.6
TOTAL EXPENSES	$25,721.6	87.1%	$29,608.2	94.8%

[1] Discrepancies may exist due to rounding.

Source: Securities Industry Database

Employment was the most significant expense item accounting for 36% of total expenses.[9/] In 1984, total employee costs declined 3% which helped to limit the rise in total expenses (Table 13). This occurred because management exercised controls to limit both employment and salary increases while compensation tied to RR production fell due to the drop in such activity. Employment peaked in the first-quarter of 1984 as average employment last year rose moderately compared with 1983 (Table 14).[10/] Reductions were made in clerical-administrative and other support personnel in the second and third quarters but registered representatives and other income producing personnel continued to rise throughout the year.

9/ Partners' and stockholders' employment costs are excluded from employment expenses.

10/ The following methodology was used to estimate the variables responsible for the change in employment expense by type of employee: (1) number of employees and (2) average compensation.

A. For RRs

RN_3 = average number of RRs in 1983
RN_4 = average number of RRs in 1984

RC_3 = average compensation per RR in 1983
RC_4 = average compensation per RR in 1984

$\triangle EE_4$ = change in employment expense in 1984

$\frac{(RN4 - RN3)(RC3)}{\triangle EE_4}$ = percentage of 1984 change in employment expense attributable to change in 1984 number of RRs

$\frac{(RC4 - RC3)(RN4)}{\triangle EE_4}$ = percentage of 1984 change in employment expense attributable to change in 1984 RR compensation

B. All Other + Non-RR Income Producing (AO + Non-RR)

ON_3 = average number of AO + Non-RRs in 1983
ON_4 = average number of AO + Non-RRs in 1984

OC_3 = average compensation per AO + Non-RR in 1983
OC_4 = average compensation per AO + Non-RR in 1984

$\frac{(ON4 - ON3)(OC3)}{\triangle EE_4}$ = percentage of 1984 change in employment expense attributable to change in 1984 number of AO + Non-RRs

$\frac{(OC4 - OC3)(ON4)}{\triangle EE_4}$ = percentage of 1984 change in employment expense attributable to change in 1984 AO + Non-RR compensation

Overall, higher 1984 average employment resulted in employment expenses increasing 8%. Compensation decreased in 1984 largely because of the 16% drop in the average compensation of RRs. Also, average compensation to all other employees declined 3.5%. Overall, the drop in compensation reduced employment expenses nearly 11%.

Table 13

Changes in Security Industry Expenses, 1983-1984[1/]

	(million of dollars) Dollars	Percent
Employment		
Registered Rep. Comp.	$(499.8)	(8.7)%
Clerical & Admin.	259.9	5.3
Other	(51.8)	(11.5)
	($291.7)	(2.6)%
Fixed Expenses		
Communications	$229.7	14.9%
Occup. & Equip.	366.6	32.2
EDP	77.6	22.7
	$673.9	22.3%
Interest	$3,454.8	57.1%
Floor Brok. & Clear.	20.4	1.8
Promotional Costs	34.8	4.7
Error Accts & Bad Debts	(20.6)	(8.9)
Partners' & Stock	(49.0)	(5.0)
Non-recurring Charges	(72.3)	(73.4)
Regulatory Fees & Exp.	11.2	8.4
Other	123.3	5.5
Total Expenses	$3,886.6	15.1%
Non-Interest Expenses	$431.8	2.2%

( ) Negative

1/Discrepancies may exist due to rounding.

Source: Securities Industry Database

Table 14

Securities Industry Employee Expense

	1982	1983	1984	% Change 1982-1983	% Change 1983-1984
Average Number of Employees					
Reg. Reps.	57,120	64,925	70,640[2/]	13.7%	8.8%
All Other[1/]	113,845	127,045	136,835	11.6	7.7
	170,965	191,970	207,475	12.2%	8.1%
Average Compensation Per Employee					
Reg. Reps.	$71,865	$88,540	$74,300[2/]	23.2%	(16.1)%
All Other[1/]	36,640	42,000	40,520	14.6	(3.5)
	$47,125	$57,740	$52,020	22.5%	(9.9)%

( ) Negative

1/ Includes clerical, administrative, other support and some income producing employees.

2/ Estimated by SIA.

Sources: Securities Industry Database and NYSE Fact Book, 1984.

Fixed expenses climbed 22% and were largely responsible for the rise in non-interest expenses. Excluding fixed expenses, non-interest expenses would have declined 3%. Occupancy and equipment contributed most to the increase followed by communications and EDP equipment costs.

Most other expense items experienced either modest increases or decreases. For example, promotional costs rose 5% and "other" increased by less than 6%. Partners' and stockholders' employment costs declined 5% while bad debts fell 9%.

In the Delphi Study, securities firm CEOs ranked control of costs as the most important factor contributing to profitability in the securities industry during the rest of this decade.[11/] In 1984, with industry profitability falling to its lowest level since 1977 and numerous firms experiencing losses, the industry had to become more serious about controlling costs.

11/ SIA and Arthur Andersen & Co., Keys to a Changing Securities World, 1985, p.41.

CONCENTRATION

Concentration, as measured by total revenues, increased in 1984 resuming the upward trend which had existed since at least 1979 and which was broken only in 1983 when favorable market conditions attracted additional firms into the industry (Table 15). The drop in industry profitability in 1984 caused a reduction in the number of NYSE firms from 405 in the fourth-quarter of 1983 to 396 in the fourth-quarter of 1984. Also, Lehman Brothers and A.G. Becker Paribas, two firms in the Top 11-25 in 1983, were acquired by two firms in the Top 10. As a result, concentration in capital rose among the Top 10 firms. The larger firms are continuing their diversification and expansion away from the securities business. It's interesting to see the different trends in concentration in commissions and total revenues.

Table 15

Securities Industry Concentration, 1979-1984

	1979	1980	1981	1982	1983	1984
Total Revenues						
Top 10	48.7%	53.1%	55.6%	57.3%	54.4%	58.8%
Top 11-25	18.6	19.4	18.7	18.7	19.6	17.1
Rest of Industry	32.7	27.5	25.8	23.9	26.0	24.1
	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%
Commissions						
Top 10	40.0%	43.6%	43.4%	42.8%	42.0%	42.1%
Top 11-25	20.0	21.1	20.8	20.9	20.8	19.1
Rest of Industry	40.0	35.1	35.8	36.4	37.2	38.8
	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%
Total Capital						
Top 10	45.8%	50.8%	50.0%	54.8%	52.8%	57.2%
Top 11-25	18.8	18.00	19.7	18.3	18.8	15.6
Rest of Industry	35.4	31.1	30.3	26.9	28.3	27.2
	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%

1/Firm rankings are by capital.

Source: Securities Industry Database

Ira Epstein
Assistant Director
of Research

SECURITIES INDUSTRY STATISTICS

VOLUME

	March 1985	YEAR-TO-DATE 1985	March 1984	YEAR-TO-DATE 1984	% CHG. Y-T-D 1985 - 1984
AVERAGE DAILY SHARE VOLUME ON					
NYSE (MILS.)*	102.6	113.2	84.3	95.5	18.5%
AMEX (MILS.)*	8.7	9.4	5.4	6.3	49.2
NASDAQ (MILS.)*	76.7	83.1	57.8	61.3	35.6
REGIONAL EXCHANGE (MILS.)*	20.2	19.6	12.4	14.1	39.0
DOLLAR VALUE OF SHARES TRADED ON					
NYSE (MILS.)	76,916	242,187	63,905	209,003	15.9
AMEX (MILS.)	2,465	7,025	1,646	5,579	25.9
ODD-LOT SHARES PURCHASED ON NYSE (THOUS.)	6,618	20,375	7,242	22,390	9.0
ODD-LOT SHARES SOLD (INCLUDING SHORT SALES) ON NYSE (THOUS.)	16,404	49,510	13,729	41,375	19.7
NYSE BLOCK VOLUME AS A PERCENT OF TOTAL SHARES TRADED	50.9	51.0	49.6	49.3	---
CONTRACTS TRADED (THOUS.)					
CBOE OPTIONS	12,060	37,236	9,515	29,075	28.1
AMEX OPTIONS	2,914	9,131	3,591	9,973	(8.4)
COMMODITY	13,602	39,667	13,959	37,597	5.5

* *MONTHLY AVERAGE*

YIELDS

(MONTHLY AVERAGES)

	March 1985	March 1984	Basis Point Chg. Mar. 85 - Mar. 84
BOND BUYER INDEX (20 BOND)	9.77	9.97	(20)
CORPORATE BOND YIELDS (MOODY'S)			
Aaa CORPORATE	12.56	12.57	(1)
Baa CORPORATE	13.69	13.99	(30)
RATIO Aaa CORPS. TO Baa CORPS.	0.92	0.90	----
MUNICIPAL BOND YIELDS (MOODY'S)	9.77	9.41	36

PRICES

(END OF MONTH)

	March 1985	March 1984	% Change Mar. 85 - Mar. 84
DOW JONES INDUSTRIALS	1266.78	1164.89	8.7
STANDARD & POOR'S 500	180.66	159.18	13.5
NYSE COMPOSITE	104.60	91.67	14.1
AMEX MARKET VALUE INDEX	229.59	211.30	8.7
VALUE LINE COMPOSITE	194.53	182.19	6.8
NASDAQ COMPOSITE	279.20	250.78	11.3

UNDERWRITING
(DOLLARS IN MILLIONS)

	FIRST QUARTER 1985	FIRST QUARTER 1984	% CHANGE 1985 - 1984
CORPORATE FINANCING (Gross New Issues)			
Total	21,017	17,909	17.4%
Common Stock	4,237	2,271	86.6
# of Common Stock Issues	126	167	(24.6)
Preferred Stock	1,045	1,114	(6.2)
# of Preferred Stock Issues	15	19	(21.1)
Corporate Debt	15,734	14,524	8.3
# of Corporate Debt Issues	227	183	24.0
MUNICIPAL FINANCING (Gross New Issues)			
Total	22,707	22,731	(0.1)%
Notes	1,802	8,138	(77.9)
Bonds	20,905	14,593	43.3

MARGIN DEBT

	March 1985	March 1984	% Change Mar. 85 - Mar. 84
MARGIN DEBT OUTSTANDING ($MILS)	23,320	22,460	3.8%
NET CHANGE IN MARGIN DEBT ($MILS)	860	8,290	89.6
% OF ACCOUNTS WITH EQUITY UNDER 40%	11	11	-------

* ALL TIME HIGH

FINANCIAL DATA FOR NYSE FIRMS DOING A PUBLIC BUSINESS
(MILLIONS OF DOLLARS)

	Fourth Quarter 1984	Yr.-To-Date 1984	Fourth Quarter 1983	Yr.-To-Date 1983	% Change 4th Q. 1984 4th Q. 1983	Yr.-To-Date % Change 1984 - 1983
REVENUE						
SECURITIES COMMISSION INCOME	$1,708	$7,095	$1,877	$8,326	(9.0)%	(14.8)%
REALIZED AND UNREALIZED GAIN OR LOSS IN TRADING AND INVESTMENT	2,577	8,278	1,659	7,571	55.3	9.3
PROFIT OR LOSS FROM UNDERWRITING AND SELLING GROUPS	871	2,706	812	3,537	7.3	(23.5)
TOTAL REVENUE	8,518	31,216	7,245	29,515	17.6	5.8
TOTAL EXPENSES	8,015	29,608	6,928	25,706	15.7	15.2
NET INCOME BEFORE TAXES	503	1,608	317	3,809	58.7	(57.8)
PERCENT OF FIRMS SHOWING LOSS	36.2%	36.5%	37.3%	14.5%	---	---

ITEM	DESCRIPTION	SOURCE
"1985 First Quarter Corporate Finance Roundup"	Statistical review of underwriting activity, including ranking of managers and co-managers overall and in various securities plus listings of the largest deals.	Investment Dealers' Digest 4/9/85
Flatter Taxes & Fatter Bases	Four-part booklet evaluating 3 leading modified flat income tax plans--Treasury, Bradley-Gephardt, and Kemp-Kasten, with emphasis on Treasury proposal. Criteria for evaluation are simplification objectives and economic impact. Simplification is considered in terms of both ease of compliance and for tax/investment planning.	Tax Foundation, Inc. One Thomas Circle, N.W. Washington, D.C. 20005 $10 per copy
IRAs--The People's Choice	Report discusses: 1. growth of IRAs, 2. structure of market, 3. characteristics and attitudes of IRA owners and non-owners, and 4. impact of IRAs on savings. Data derived in part from recent survey of households.	Investment Company Institute 1600 M Street, N.W. Washington, D.C. 20036
"How to Manage Investor Relations"	According to author Charles Ellis, the professional, institutional investor is, and has been, the dominant force in securities markets. The most effective -- and least costly -- strategy for investor relations management should be aimed at institutional investors and based on the concepts of industrial marketing. This strategy will also meet the objectives of an individual investor program because the extensive information organized for institutional investors also serves the needs of individuals.	Financial Analysts Journal March/April 1985
"Up the Revolution--Change Sweeps Over London Exchange"	A look at current activity in London as stock brokerage firms prepare for the end of fixed commissions, scheduled for late 1986. Expected changes have set off regroupings, with almost every major brokerage firm linking up with capital-rich partners. Driving force behind link-ups reportedly British, American and Swiss Banks.	Barron's 4/22/85

RECENT INTERESTING READING AND STATISTICAL MATERIAL

ITEM	DESCRIPTION	SOURCE
Keys to a Changing Securities World	SIA/Arthur Andersen Delphi study of the securities industry in the late 1980s, on which the presentations at the SIA Spring Meeting were based.	Communication Services Arthur Andersen & Co. 69 West Washington St. Chicago, Illinois 60602 $50 SIA members; $75 others
Interim Report on Sales Compensation Practices in the Securities Industry	Based on survey of compensation plans in effect in latter part of 1984 and payouts, ticket sizes, etc. in 1983. Report presents demographic statistics on 39 participating firms, summary highlighting major features of industry compensation plans, complete sales compensation plans in effect in 1981 and 1984 at participating firms, and changes in those plans recently implemented or anticipated.	SIA Publications Dept. $275 SIA members; $550 others
"Tax Reform" Four-part Editorial Series	Common sense observations on the tax reform debate. Key to writing tax reform bill targeted at economic growth is overcoming constraints of Treasury's static revenue neutrality. There is more to gain by reducing incentives for tax avoidance and uneconomic allocation than there is to lose through lower marginal rates. Revenues were generated by the 1978 capital gains tax cut and, despite the 1981 rate reductions, those with incomes of $100,000+ paid higher taxes in 1982 and 1983.	Wall Street Journal April 3--15